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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER MAY 12 2006
ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Manufacturing Production Recovers in March;
- Record Credit Growth Sparks Inflation Concerns;
- Tourism Industry Key Contributor to Higher Growth;
- Net Reserves Above $20 Billion;
- SARS Expects to Increase 2006 Tax Returns;
- 5% Import Duty on Steel Removed;
- Treasury Withholds Funds to Four Cities for the First Time; and
- South Africa Improves in Competitive Rankings.

End Summary.

Manufacturing Production Recovers in March

¶2. Manufacturing production resumed its over 5% growth in March, reaching 5.7% from February's growth of 4%. So far, 2006's manufacturing growth has shown substantial improvement, with production growing by 5.2% during the first quarter 2006, compared to 4th quarter 2005's growth of 3.5%. The major contributors in the acceleration of first quarter's growth include the motor vehicle, petroleum and chemicals, and textile industries, although communication and glass and non-metallic product industries showed declines in quarterly growth. The recent acceleration in manufacturing growth matches similar improvement shown by other indicators of manufacturing activity, such as Investec's Purchasing Manager's Index (PMI). For the past two months, PMI has indicated that current manufacturing activity has expanded, with trade expectations at levels indicating activity should improve over the next six months. Source: Statistics SA Release P3041.2 and Standard Bank's Manufacturing Unpacked, May 11.

Record Credit Growth Sparks Inflation Concerns
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¶3. In March, private sector credit demand increased by 24.3%, from February's 21.5% growth, and higher than the expected 22.4% increase. March's increase in private sector credit demand is the single largest monthly increase. M3, the broad measure of money supply, grew by 26.8% in March compared to a 21.1% increase in February.

In March, mortgages increased by 30%, investments by 28%, installment sales by 19%, and leasing finance by 21%. Tax relief for individuals announced in the February budget and strong growth in equity markets might have increased deposits with the banking sector, while the sharp reduction in transfer duties on property might have been a factor leading to sharp growth in mortgages. In the fourth quarter 2005, household debt to disposable income reached 65.6% and the latest credit growth suggests that debt levels will continue to increase. Johan Rossouw, the chief economist at Vunani Securities, said while consumer borrowing had pushed debt ratios to record levels, the cost of servicing debt remained relatively low, about 7% of disposable income. He viewed the latest credit growth increasing the probability of a rate increase at the next Monetary Policy Committee meeting to 50%. Source: Standard Bank's Money Supply Alert, May 5; Business Report, May 8.

¶4. Comment. The next Monetary Policy Committee meeting is scheduled for June 7. Recent statements by both South African Reserve Bank governor Tito Mboweni and Finance Minister Trevor Manuel have pointed out the dangers of increasing consumer debt if interest rates rise, leading to increasing expectations of the SARB leaning towards future interest rate hikes. Although most expect interest rates to remain unchanged in June, a growing number of forecasts expect higher interest rates by year end. End comment.

Tourism Industry Key Contributor to Higher Growth
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¶5. Deputy President Phumzile Mlambo-Ngcuka emphasized the importance of tourism in meeting the Accelerated Shared

Growth Initiative's goal of increasing South Africa's growth to 6% by 2010. Currently, tourism created one job for every 12 tourists arriving in South Africa. The number of tourists arriving in South Africa reached 7 million in 2005, compared to 1 million in 1990. More than 60% of South African arrivals were from Africa. Mlambo-Ngcuka said government was working to increase air slots in line with demand. A `univisa' granting easier travel access to visitors from Southern African Development Community countries was also planned. Most tourists travel to three provinces: KwaZulu-Natal, Gauteng, and Western Cape. Mlambo-Ngcuka wants to diversify tourist destinations to achieve higher growth in other parts of the country. Source: Business Day, May 8.

Net Reserves Above $20 Billion

¶6. South Africa's net reserves rose by $579 million (R3.5 billion) in April to reach $20.07 billion slightly above $20 billion, a level seen internationally as a milestone for emerging markets. Gross reserves increased to $23.8 billion from $23 billion at the end of March. The improvement in South African reserves has led several credit rating agencies to improve their South African ratings. In August 2005, Standard & Poor's increased South Africa's long term foreign currency and local currency ratings on South Africa to BBB+ and A+, respectively, equivalent to Moody's rating of Baa1, with both ratings being 3 notches above junk status. Moody's rated South Africa two levels above India and five above Brazil's ratings score. However in April, Moody's suggested that South Africa's widening current account deficit could prevent a further upgrade in its credit rating in the near term. South Africa's deficit on current account reached 4.2% of GDP in 2005 from 2004's 3.4% of GDP. The increasing deficit on the current account will put pressure on the rand if it is not financed by incoming capital inflows. Source: Business

Report, May 9.

SARS Expects to Increase 2006 Tax Returns

¶7. According to Finance Minister Trevor Manuel, the South African Revenue Service (SARS) expects to increase SA's national tax returns by 8%-12% in 2006. SARS also plans to process 80% of correctly compiled tax returns within 90 days during peak periods (July to February) and 34 working days during off-peak periods. Tax returns increased 8% in 2005, where 14 million returns were processed, with 330,000 new taxpayers. Currently, there are about 1.4 million corporate taxpayers and 4.5 million individual taxpayers on the register. SARS also introduced an electronic submission facility for 2.7 million taxpayers, planned to be available from June 1. According to Manuel, improving of tax compliance in South Africa had contributed to a reduced budget deficit, significant tax relief, and a general lower tax burden for all. SARS collected R418.1 billion in fiscal 2005-06, exceeding a revised target of R417 billion. Source: Business Day, May 10.

5% Import Duty on Steel Removed

¶8. Mandisi Mpahlwa, the Minister of Department of Trade and Industry (DTI), signed regulations to remove the 5% duty on steel imports. A review of the import-parity pricing policies is continuing and should be completed by June. The review will determine which specific legislative changes will be introduced to the Competition Act. Tshediso Matona, the Acting Director-General in DTI, emphasized that proposed changes in the import pricing policies would involve all concerned industries and not just the steel industry. Source: Business Report, May ¶10.

Treasury Withholds Funds to Four Cities for the First Time
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¶9. For the first time, National Treasury withheld grants worth R95 million ($15.8 million, using 6 rands per dollar) from Cape Town, Nelson Mandela (Port Elizabeth),

Emfuleni (Vereeniging) and Mangaung (Bloemfontein) metropolitan councils, because they failed to comply with conditions laid down for the grants. At a hearing in Parliament, Lungise Fuzile, Treasury's Deputy Director-General for intergovernmental relations, described the conditions that each municipality had to fulfill before the restructuring grants could be given. Indicators include regular credit ratings by independent assessors, sustainable debt ratios, and a revenue collection ratio approaching 97%. Municipalities had to show consistent progress towards these goals. The amount of withheld money was relatively small. Cape Town lost R30 million ($5 million), Nelson Mandela R20 million ($3.3 million), Emfuleni R35 million ($5.8 million), and Mangaung R10 million ($1.6 million). Source: Business Report, May 11.

South Africa Improves in Competitive Rankings

¶10. In the annual IMD International's World Competitiveness Yearbook, South Africa improved by 2 positions, reaching 44th out of 61 countries ranked, due to better governance. South Africa's current ranking is closer to its highest of 39th in 2002. Its 2003 and 2004 rankings declined to 47 and 49, respectively, although 10 additional economies were included in the overall rankings in 2003. The ranking is based on government efficiency, business efficiency, economic performance and infrastructure. The biggest gain was in government

efficiency with the country moving from 34th place to 28th. Reasons for the improvement included the lower effective personal income tax rate as a percentage of GDP, management of public finances and policy direction of government. Factors holding back further improvement in South Africa's governance ranking included immigration laws, personal security and labor regulations. South African business improved its ranking to 38th place from 40th place in 2005. Improvements in business came because of a rise in stock market capitalization as a percentage of GDP, a rise in the female labor force as a percentage of total employment, social responsibility of business leaders, protection of shareholder rights, and improved auditing and accounting practices. Leading to deterioration in South African business competitiveness was the unavailability of skilled labor, a decline in the labor force as a percentage of the population, the brain drain and worsening labor relations. South Africa's worst performance was its infrastructure ranking, dropping to 60th place from 2005's 58th ranking. In terms of economic performance, South Africa fell from 42nd to 46th. The report listed overall factors that influenced South Africa's ranking. Among the improvements noted were direct and portfolio inward investment, total reserves, high technology exports, value traded on the JSE, ease of doing business, a reduction in tax evasion, the legal and regulatory framework, and quality of life. The negative factors include a rise in the consumer price index from 1.4% in 2004 to 3.4% in 2005, a fall in direct investment abroad, a larger current account deficit, concerns about energy infrastructure, a decline in tourism receipts, a decline in exports of commercial services, the brain drain and poor implementation of government decisions. Source: Business Report, May 11.

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